

Journal of the National Association of Administrative Law Judiciary

Volume 33 | Issue 2

Article 8

10-15-2013

Missing the Mark: Partial Resolution of the Application of Equitable Tolling to Section 16(b) Claims in Credit Suisse Securities (USA) LLC v. Simmonds

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Missing the Mark: Partial Resolution of the Application of Equitable Tolling to Section 16(b) Claims in *Credit Suisse Securities (USA) LLC v. Simmonds*

By Lydia Park*

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I. INTRODUCTION

This case note will focus on the Supreme Court's decision in *Credit Suisse Securities (USA) LLC v. Simmonds*.¹ The case focused on the issue of whether equitable tolling principles should be applied to the section 16(b) provision of the Securities Exchange Act of 1934 and, if so, what standard for equitable tolling should be applied—generally established principles or a derivative version.²

The Securities and Exchange Commission (SEC) was created to monitor stock creation and trading.³ Section 16 of the Securities Exchange Act of 1934⁴ sets out the guidelines for short-term stock trading by “[d]irectors, officers, and principal stockholders.”⁵ Section 16(a) addresses the disclosure of trading activities by corporate insiders.⁶ Section 16(b) prohibits insider trading based on

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¹ 132 S. Ct. 1414 (2012).

² See generally *id.*

³ See generally U.S. SECURITIES AND EXCHANGE COMMISSION, <http://www.sec.gov/index.htm> (last visited Jan. 17, 2013); see *infra* Part II.B and notes 32–35 for more details on its creation.

⁴ 15 U.S.C. § 78p (2012).

⁵ *Id.*

⁶ 15 U.S.C. § 78p(a). The term “insider” usually describes a director, officer, or principal stockholder. Also, the SEC describes “insider trading” in the following manner:

“Insider trading” is a term that most investors have heard and usually associate with illegal conduct. But the term actually includes both legal and illegal conduct. The legal version is when corporate insiders—officers, directors, and

short-swing profits—the purchase and sale of shares within six months—and creates a cause of action for the breach of that prohibition. Section 16(a)(1) reads:

Every person who is directly or indirectly the beneficial owner of more than 10 percent of any class of any equity security (other than an exempted security) which is registered pursuant to section 78l of this title, or who is a director or an officer of the issuer of such security, shall file the statements required by this subsection with the Commission.⁷

Thus, the ten percent shareholding threshold applies only to “beneficial owners” who are not directors or officers.⁸ Section 16(b), which is the relevant statute in the case at hand, reads in part: “any profit realized by [a beneficial owner, director, or officer] from any purchase and sale, or any sale and purchase, of any equity security of [an] issuer . . . within any period of less than six months . . . shall inure to and be recoverable by the issuer”⁹ The statute allows suit to be brought by either the issuer or by an owner of the issuer’s

employees—buy and sell stock in their own companies. When corporate insiders trade in their own securities, they must report their trades to the SEC. . . .

Illegal insider trading refers generally to buying or selling a security, in breach of a fiduciary duty or other relationship of trust and confidence, while in possession of material, nonpublic information about the security.

Education, Fast Answers: Insider Trading, U.S. SECURITIES AND EXCHANGE COMMISSION, <http://www.sec.gov/answers/insider.htm> (last visited Oct. 23, 2013).

⁷ 15 U.S.C. § 78p(a)(1).

⁸ A “beneficial owner” is the actual owner of the shares who holds voting power. 17 C.F.R. § 240.13d–3 (2013). For details on what qualifies as a registered stock, see 15 U.S.C. § 78l.

⁹ 15 U.S.C. § 78p(b).

shares.¹⁰ The statute sets the statute of limitations to no more than two years after a profit was made.¹¹

Simmonds brought to the Supreme Court, among other topics for debate, the issue of whether the statute of limitations set by section 16(b) can be tolled.¹² The well-established purpose of a statute of limitations is “to protect defendants against stale or unduly delayed claims.”¹³ The equitable tolling doctrine is a judicially created doctrine that essentially tolls the statute of limitations to protect a person from fraudulent concealment of an unlawful act.¹⁴

Before the Supreme Court’s decision in this case, the following three-way split existed among courts across the country: (1) no application of equitable tolling (e.g., District Court for the Eastern District of Tennessee); (2) application of generally established principles of equitable tolling (e.g., Delaware State Court of Chancery); and (3) application of an altered principle of equitable tolling (e.g., Ninth and Second Circuits).¹⁵ The Court’s decision in *Simmonds* essentially narrows the scope by eliminating the third method.¹⁶ The Court’s opinion on the issue of whether equitable tolling even applies at all is less satisfactory, as it merely assumed tolling only for the purpose of determining the narrower issue of whether the Ninth Circuit’s rationale was valid or not.¹⁷ The opinion, although divided and without precedential effect, affirms the Court of Appeals for the Ninth Circuit’s rejection of the petitioner’s “contention that § 16(b) establishes a period of repose that is not subject to tolling.”¹⁸

¹⁰ *Id.*; see also *infra* Part II.B.2.

¹¹ 15 U.S.C. § 78p(b).

¹² See *Credit Suisse Sec. (USA) LLC v. Simmonds*, 132 S. Ct. 1414, 1417 (2012).

¹³ *Id.* at 1420 (citing *John R. Sand & Gravel Co. v. United States*, 552 U.S. 130, 133 (2008)).

¹⁴ See *infra* Part II.C–D for an in-depth discussion of the equitable tolling doctrine.

¹⁵ See *infra* Part II.D.1.

¹⁶ *Simmonds*, 132 S. Ct. at 1418, 1421 n.7; see *infra* Part II.D.1.a.

¹⁷ *Simmonds*, 132 S. Ct. at 1419, 1421.

¹⁸ *Id.* at 1421.

This case note will focus on the non-precedential, yet important, decision made in *Simmonds*. Because Supreme Court decisions carry the utmost authority, it essentially leaves only one option for circuit courts—case-by-case review under the traditional equitable tolling doctrine. However, because the Court made certain to explicitly state that its decision on whether section 16(b)'s time limit is a limitation or a repose carries no precedent, lower courts have been left with the freedom to ascertain for themselves congressional intent on the matter.

Part II of this case note will lay out the applicable statutes and judicial principles, examining how the courts have applied them to their decisions prior to the Supreme Court's ruling in *Simmonds*.

Parts III and IV will comment on the relevant facts of the case and the issues brought up in the lower court proceedings, then move on to the Court's opinion—including the level of deference the Court has afforded congressional intent when analyzing section 16(b) and the Court's rationale in eliminating the prevalent third school of thought (altered principle) on equitable tolling. These sections will also explain the implications of the Court's decision to focus on certain issues and not others.

Part V of this note will follow with an analysis of the reaction from the legal community and other related industries, and will examine how the *Simmonds* decision has impacted the circuit courts in applying the relevant statutes and principles. Then the section will review Supreme Court findings in related or similar circumstances—namely, the Court's rationale regarding application of equitable tolling for section 10(b) antifraud claims under the Securities Exchange Act of 1934—and review the circuit court decisions subsequent to *Simmonds*, in order to assess what the circuit split may be in the future and how the Supreme Court might rule if the same issue were to come up at a later date. The note will also review important congressional reactions enacted subsequent to the Supreme Court holdings on equitable tolling for section 10(b) claims in order to assess legislative intent for statute of limitations in securities law and whether the Court correctly identified such intent.

II. HISTORICAL BACKGROUND

A. *Pre-Federal Securities Legislation Era*

The Supreme Court has stated that “[c]orporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law *expressly* requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation.”¹⁹ Today, state laws continue to govern many aspects related to corporations—for example, corporate governance. However, after state laws proved lacking, the area of securities regulations received express federal governance.

1. State Blue Sky Laws

Blue Sky Laws are securities laws enacted by individual states.²⁰ These laws originated before Congress passed the Securities Act of 1933 and the Securities Exchange Act of 1934, or even before Congress formed a centralized commission to oversee the securities markets.²¹ The prominence of questionable securities-related practices became the impetus for regulating the promotion of “fraudulently valued securities.”²² In 1911, the state of Kansas first passed a securities act in this respect, which attracted the attention of other states and was “popularly called a ‘blue sky law[.]’”²³ These

¹⁹ *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 479 (1977) (emphasis added).

²⁰ *Education, Fast Answers: Blue Sky Laws*, U.S. SECURITIES AND EXCHANGE COMMISSION, <http://www.sec.gov/answers/bluesky.htm> (last visited Oct. 23, 2013).

²¹ See *infra* note 23 and accompanying text; see also *infra* Part II.B.

²² ROBERT W. HAMILTON, JONATHAN R. MACEY & DOUGLAS K. MOLL, *CASES AND MATERIALS ON CORPORATIONS INCLUDING PARTNERSHIPS AND LIMITED LIABILITY COMPANIES* 304–05 (11th ed. 2010).

²³ JAMES D. COX & THOMAS LEE HAZEN, 4 *TREATISE ON THE LAW OF CORPORATIONS* § 27:3 (3d ed. 2010). The term “blue sky law” derives itself from the “purpose to protect the Kansas farmers against the industrialists selling them a piece of the blue sky.” HAMILTON, MACEY & MOLL, *supra* note 22, at 305.

state securities laws, now in effect in all the states, “protect investors against issuers having nothing behind their securities but water or blue sky.”²⁴ Blue Sky Laws attempt to “prevent unscrupulous dealers foisting on inexperienced persons unfair, spurious, and worthless securities, and further to provide some method of supervision and regulation of the marketplace.”²⁵

Despite these attempts to prevent fraudulent securities transactions at the state level, these laws have not been very effective on a national level.²⁶ The state laws “required that all securities registered thereunder ‘qualify’ on a merit basis,” and for a while this “broad regulatory potential” approach pushed back federal involvement until the Wall Street crash of 1929.²⁷

2. The Beginnings of Federal Involvement in the Regulatory Landscape

After the 1929 crash, Congress passed the Securities Act of 1933 (1933 Act), also known as the “Truth in Securities” Act.²⁸ Congress had considered and rejected the “merit approach” of the state blue sky laws, “opting instead for a system of full disclosure” under the theory “that investors are adequately protected if all . . .

²⁴ COX & HAZEN, *supra* note 23, at § 27:3:

As one court put it: “The name that is given to the law indicates the evil at which it is aimed, that is, ‘speculative schemes which have no more basis than so many feet of “blue sky”’; or, as [it has been] stated, . . . ‘to stop the sale of stock in fly-by-night concerns, visionary oil wells, distant gold mines, and other like fraudulent exploitations.’”

Id. (alteration in original) (footnote omitted).

²⁵ *Id.*

²⁶ HAMILTON, MACEY & MOLL, *supra* note 22, at 305.

²⁷ *Id.* The crash of the stock market in 1929, which marked the beginning of the ten-year era known as The Great Depression, was “viewed as the straw that broke the camel’s back.” *Id.*

²⁸ *Id.*

aspects of the securities being marketed are fully and fairly disclosed and thus there is no need for the more time-consuming merit analysis of the securities being offered.”²⁹ The Federal Trade Commission administered this “limited” act until Congress passed the Securities Exchange Act of 1934 the next year.³⁰

B. Adoption of the Securities Exchange Act of 1934 and Section 16’s Prohibition of Insider Trading

After enactment of the 1933 Act, which governed the registration of securities to “enable[] investors . . . to make informed judgments about whether to purchase a company’s securities,”³¹ Congress passed the Securities Exchange Act of 1934 (1934 Act) and simultaneously created the Securities and Exchange Commission (SEC).³² The 1934 Act grants the SEC “broad authority over all aspects of the securities industry”—it “identifies and prohibits certain

²⁹ *Id.*

³⁰ *Id.* Although the 1933 Act contained both “private remedies for investors who are injured due to violations” and “general anti-fraud provisions which bar material omissions and misrepresentations in connection with the sale of securities,” it was limited because it only addressed “distributions of securities” and protected only those investors who were “purchasers of securities.” *Id.* at 305–06.

³¹ *About the SEC, The Laws that Govern the Securities Industry*, U.S. SECURITIES AND EXCHANGE COMMISSION, <http://www.sec.gov/about/laws.shtml> (last visited Oct. 23, 2013) [hereinafter *The Laws that Govern the Securities Industry*].

³² *Id.*; see also HAMILTON, MACEY & MOLL, *supra* note 22, at 306 (footnotes omitted):

In 1934 Congress enacted the Securities Exchange Act of 1934 which is a more omnibus regulation. The extent of the regulation was so vast that Congress felt it was not possible to continue overburdening the Federal Trade Commission with this new administrative responsibility and thus established the Securities and Exchange Commission [“SEC”] which is now one of the largest federal agencies. The Exchange Act of 1934 is directed at regulating all aspects of public trading of securities.

types of conduct in the [securities] markets and provides the [SEC] with disciplinary powers over regulated entities and persons associated with them.”³³ The SEC’s self-proclaimed mission is “to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.”³⁴ In order to fulfill its dual purpose of (1) “promot[ing] stability in the markets” and (2) “protect[ing] investors,” the SEC oversees those who participate in securities transactions in order to maintain fair dealings and prevent fraud.³⁵

1. Insider Trading Provisions of the Securities Exchange Act of 1934

One of the enumerated types of conduct prohibited by the Act of 1934 is insider trading.³⁶ The SEC homepage offers insight into the commission’s description of insider trading:

The securities laws broadly prohibit fraudulent activities of any kind in connection with the offer, purchase, or sale of securities. These provisions are the basis for many types of disciplinary actions, including actions against fraudulent insider trading. Insider trading is illegal when a person trades a security while in possession of material nonpublic information in violation of a duty to withhold the information or refrain from trading.³⁷

³³ *The Laws that Govern the Securities Industry*, *supra* note 31.

³⁴ *About the SEC, What We Do*, U.S. SECURITIES AND EXCHANGE COMMISSION, <http://www.sec.gov/about/whatwedo.shtml> (last visited Oct. 23, 2013) [hereinafter *What We Do*].

³⁵ *Id.*

³⁶ *The Laws that Govern the Securities Industry*, *supra* note 31.

³⁷ *Id.*

Despite the fact that the SEC clearly states that protection of investors is its most important mission,³⁸ one will not find an “express statutory prohibition” of insider trading in the Securities Acts.³⁹ As a result, “most insider trading cases are based on Rule 10b-5’s general antifraud provisions, which do not specifically mention insider trading.”⁴⁰ There are three sections in the 1934 Act that expressly address insider trading, but on a limited scope. Of those, section 16(b) prohibits “*short swing* profit by designated statutory insiders.”⁴¹ The other sections only address remedies for insider trading, but remain silent on the “substantive question of what types of conduct comprise improper trading of nonpublic information.”⁴²

³⁸ “Congress established the Securities and Exchange Commission in 1934 to enforce the newly-passed securities laws, to promote stability in the markets and, *most importantly*, to protect investors.” *What We Do*, *supra* note 34 (emphasis added).

³⁹ 4 THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 12.17 (6th ed. 2009).

⁴⁰ *Id.*

⁴¹ *Id.*; see also *supra* Part I and text accompanying note 9.

⁴² HAZEN, *supra* note 39. Section 20A(a) designates a private right of action against contemporaneous trading based on inside information:

Any person who violates any provision of this title or the rules or regulations thereunder by purchasing or selling a security while in possession of material, non-public information shall be liable in an action in any court of competent jurisdiction to any person who, contemporaneously with the purchase or sale of securities that is the subject of such violation, has purchased (where such violation is based on a sale of securities) or sold (where such violation is based on a purchase of securities) securities of the same class.

15 U.S.C. § 78t-1 (2012). Classes of securities are “[t]ypes of listed company stock that are differentiated by the level of voting rights shareholders receive.” *Dictionary, Class of Shares*, INVESTOPEDIA, <http://www.investopedia.com/terms/c/class.asp> (last visited Mar. 18, 2013). Section 21A(a)(1) addresses the SEC’s authority to seek civil penalties for insider trading:

2. Section 16 of the Securities Exchange Act of 1934

Section 16 is a “regulatory framework enacted by Congress to proscribe the use of confidential information by corporate insiders in the trading of equity of their issuers.”⁴³ The section specifically deals with a narrow subset of “stock trading often associated with the misuse of inside information—short-swing trading.”⁴⁴

Whenever it shall appear to the Commission that any person has violated any provision of this title or the rules or regulations thereunder by purchasing or selling a security or security-based swap agreement while in possession of material, nonpublic information in, or has violated any such provision by communicating such information in connection with, a transaction on or through the facilities of a national securities exchange or from or through a broker or dealer, and which is not part of a public offering by an issuer of securities other than standardized options or security futures products, the Commission—

(A) may bring an action in a United States district court to seek, and the court shall have jurisdiction to impose, a civil penalty to be paid by the person who committed such violation; and

(B) may, subject to subsection (b)(1), bring an action in a United States district court to seek, and the court shall have jurisdiction to impose, a civil penalty to be paid by a person who, at the time of the violation, directly or indirectly controlled the person who committed such violation.

15 U.S.C. § 78u-1(a)(1).

⁴³ 15 U.S.C. § 78p.

⁴⁴ ALAN PALMITER & FRANK PARTNOY, CORPORATIONS: A CONTEMPORARY APPROACH 891 (2010). Short-swing trading is a “purchase and resale . . . of company stock within a relatively short period of time.” *Id.* The original rationale for the six-month period defining “short-swing” in the provision comes from the fact that the “capital gains period of the tax laws was then six months, [so] there was good reason to suspect that . . . someone . . . who bought and sold within six months,” foregoing tax advantages for longer-held profits, “was doing so to take advantage of some special knowledge.” *Id.*

Section 16 seeks to prevent such abuses of inside information by means of a threefold attack.⁴⁵ Section 16(a) requires insiders to make SEC filings of shareholding and transactions; section 16(b) creates a private cause of action for the issuer or shareholder to bring a claim to recover the “short-swing” profits made by insiders; and section 16(c) “prohibits such insiders from transacting short sales in the issuer’s equity securities.”⁴⁶ Through such a threefold attack, Congress intended to “curb the evils of insider trading [by] . . . taking the profits out of a class of transactions in which the possibility of abuse was believed to be intolerably great.”⁴⁷ Section 16(b) explicitly states that the purpose of the section is to “prevent[] the unfair use of information which may have been obtained . . . by reason of [a] relationship to the issuer” for short-swing profits.⁴⁸

⁴⁵ Marc I. Steinberg & Daryl L. Landsdale, Jr., *The Judicial and Regulatory Constriction of Section 16(B) of the Securities Exchange Act of 1934*, 68 NOTRE DAME L. REV. 33, 34 (1992).

⁴⁶ *Id.* at 34.

⁴⁷ *Id.* at 36 (quoting *Reliance Elec. Co. v. Emerson Elec. Co.*, 404 U.S. 418, 422 (1972)). The Supreme Court in *Reliance* held that the only effective method is a “flat rule.” 404 U.S. at 422; *see also* *Bershad v. McDonough*, 428 F.2d 693 (7th Cir. 1970) (holding that strict liability applies regardless of intent).

⁴⁸ 15 U.S.C. § 78p(b).

For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) . . . within any period of less than six months, unless such security . . . was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after the request or shall fail diligently to prosecute the

a. Standard of Application of Section 16(b)

The correct standard to apply when analyzing a claim under section 16(b) is the objective approach—“where alternative constructions of the terms of § 16(b) are possible, those terms are to be given the construction that best serves the congressional purpose of curbing short-swing speculation by corporate insiders”⁴⁹—unless the circumstances represent a borderline situation that calls for a subjective and pragmatic approach—“courts inquire whether the transaction involved carries a potential for insider abuse. Only those types of transactions which do are then found included within the statutory scope.”⁵⁰ But otherwise, for “garden-variety transaction[s] which cannot be regarded as unorthodox, the pragmatic approach is not applicable.”⁵¹

b. Section 16(b)’s Two-Year Statute of Limitations

Section 16(b)’s private right of action also contains a prescribed time limitation: “no such suit shall be brought more than two years after the date such profit was realized.”⁵² This portion of the statute is the central issue in *Simmonds*, which the Supreme Court addressed before considering the merits of the case. Can this statute of limitations be tolled, and if so, when does the clock begin to run?

same thereafter; but no such suit shall be brought more than two years after the date such profit was *realized*.

Id. (emphasis added).

⁴⁹ See *Whittaker v. Whittaker Corp.*, 639 F.2d 516, 522 (9th Cir. 1981) (quoting *Reliance*, 404 U.S. at 424), *abrogated by* *Credit Suisse Sec. (USA) LLC v. Simmonds*, 132 S. Ct. 1414 (2012)) (citation omitted).

⁵⁰ *Whittaker*, 639 F.2d at 522 (quoting *Kern Cnty. Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 594–95 (1973)).

⁵¹ *Id.*

⁵² 15 U.S.C. § 78p(b).

c. *The Underwriter Exemption to Section 16(b)*

The SEC “has relaxed a number of rules in this area” regarding section 16(b) claims.⁵³ This includes relaxing rules regarding: (1) an insider’s exercise of an option and immediate sale of underlying security after the six-month holding period, and (2) the purchase or sale by an “individual before . . . [becoming] an officer or director and the subsequent offsetting transaction after such person attains insider status.”⁵⁴

Regarding underwriters, “The SEC has carved out an underwriter exemption to both disclosure under 16(a) and disgorgement under 16(b) . . . when acting in good faith and in the ordinary course of business.”⁵⁵ The “underwriter exemption,” as it has come to be known, originated in 1935 under a rule called NB2 that exempted “certain transactions by underwriters from the provisions of Section 16(b) of the Securities Exchange Act.”⁵⁶ The conditions of this exemption were relaxed on several occasions,⁵⁷ and the current exemption standard can be found under 17 C.F.R. § 240.16a-7(a) for exemption from 16(a) disclosures,⁵⁸ and under 17

⁵³ Steinberg & Landsdale, *supra* note 45, at 38.

⁵⁴ *See id.*

⁵⁵ Boris Rappoport, *Discovering Concealment: Defining the Limits of Equitable Tolling in Section 16(b) of the Securities Exchange Act*, 7 DUKE J. CONST. L. & PUB. POL’Y SIDEBAR 171, 172 (2012), available at http://scholarship.law.duke.edu/djclpp_sidebar/85/ (describing the reasons that the SEC has given for the exemptions in this section).

⁵⁶ Exchange Act Release No. 264, 1935 WL 29156, at *1 (June 8, 1935).

⁵⁷ *See* ARNOLD S. JACOBS, 5A DISCLOSURE AND REMEDIES UNDER THE SECURITIES LAWS § 4:202 (2005); *see also* Exchange Act Release No. 535, 1936 WL 31535 (Mar. 19, 1936); Amendment to Rule NB2, Exchange Act Release No. 1080, 1937 WL 31412 (Feb. 27, 1937); Exchange Act Release No. 3907, 1947 WL 25432 (Jan. 29, 1947); Exchange Act Release No. 4719 (June 18, 1952); Adoption of Amendments, Exchange Act Release No. 4754, 1952 WL 47481 (Sept. 24, 1952); Exchange Act Release No. 6103, 1959 WL 7138 (Oct. 29, 1959); Exchange Act Release No. 6131, 1959 WL 7166 (Dec. 4, 1959).

⁵⁸ *See* 17 C.F.R. § 240.16a-7(a) (2013). The provision exempts anyone “engaged in the business of distributing securities” who participates in a “distribution of a substantial block of securities” as long as he or she “participat[es] in good faith, in the ordinary course of such business.” *Id.* § 240.16a-7(a)(1).

C.F.R. § 240.16a-10 for exemption from section 16(b): “Except as provided in § 240.16a-6, any transaction exempted from the requirements of section 16(a) of the Act, insofar as it is otherwise subject to the provisions of section 16(b), shall be likewise exempt from section 16(b) of the Act.”⁵⁹

The original suit in *Simmonds* involved a challenge to this exemption.⁶⁰ However, the Supreme Court did not reach the merits of this challenge due to its ruling on the statute of limitations and equitable tolling.⁶¹

C. The Equitable Tolling Doctrine

The equitable tolling doctrine is a judicially created principle.⁶² The doctrine attempts to harmonize the two contrasting policy considerations of minimizing unfairness arising from: (1) the bar that the statute of limitations places on litigants acting with a good faith effort; and (2) outdated and stale claims that should have, and could have, been brought at an earlier time.⁶³ However, to mitigate an influx of claims under such an “extraordinary remedy,” both the legislative and judicial branches have “limited [it] to rare and exceptional circumstances” and “applied [it] sparingly.”⁶⁴ To understand the doctrine, it is necessary not only to address the

⁵⁹ *Id.* § 240.16a-10.

⁶⁰ See *infra* Part III.A–B for a detailed discussion of the claims brought by *Simmonds* against the underwriters.

⁶¹ See *Credit Suisse Sec. (USA) LLC v. Simmonds*, 132 S. Ct. 1414, 1419 (2012).

⁶² *Arivella v. Lucent Techs., Inc.*, 623 F. Supp. 2d 164, 176 (D. Mass. 2009).

⁶³ *Machules v. Dep’t of Admin.*, 523 So. 2d 1132, 1134 (Fla. 1988) (“The tolling doctrine is used in the interests of justice to accommodate both a defendant’s right not to be called upon to defend a stale claim and a plaintiff’s right to assert a meritorious claim when equitable circumstances have prevented a timely filing.”); see also *Naton v. Bank of Cal.*, 649 F.2d 691, 696 (9th Cir. 1981) (explaining that “equitable tolling . . . focuses on the plaintiff’s excusable ignorance of the limitations period and on lack of prejudice to the defendant.”).

⁶⁴ 54 C.J.S. *Limitations of Actions* § 134 (2010) (footnote omitted).

doctrine's principles, but to briefly touch upon the principles of equitable estoppel, statute of limitations, statute of repose, and the application of the doctrine by federal and state legislatures.

1. Origin and General Application

Equitable tolling is judicially created;⁶⁵ nevertheless it “has a legal basis arising out of common law.”⁶⁶ It “permits a plaintiff to sue after the statutory time period has expired if he or she has been prevented from doing so due to inequitable circumstances.”⁶⁷ In the case of fraud, the clock does not start to tick for a statute of limitations until “discovery of the fraud ‘where the party injured by the fraud remains in ignorance of it *without any fault or want of diligence or care on his part.*’”⁶⁸

The burden of persuasion lies with the party seeking application of equitable tolling, where the party must “establish a compelling basis for awarding such relief.”⁶⁹ This “compelling basis” standard attaches a narrow standard and safeguards against overextending the doctrine.⁷⁰ Courts determine whether or not to apply the doctrine with a case-by-case review.⁷¹

In *Pace v. DiGuglielmo*, the Supreme Court set the *prima facie* case for the equitable tolling doctrine to apply.⁷² The Court

⁶⁵ *Arivella*, 623 F. Supp. 2d at 176.

⁶⁶ 51 AM. JUR. 2D *Limitation of Actions* § 153 (2011).

⁶⁷ 54 C.J.S. *Limitations of Actions* § 134 (footnote omitted).

⁶⁸ *Credit Suisse Sec. (USA) LLC v. Simmonds*, 132 S. Ct. 1414, 1420 (2012) (quoting *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 363 (1991)).

⁶⁹ 54 C.J.S. *Limitations of Actions* § 134 (footnote omitted). Sufficient basis have included “when the plaintiff has been mislead [sic] or lulled into inaction, has in some extraordinary way been prevented from asserting his or her rights, or has timely asserted his or her rights mistakenly in the wrong forum.” *Id.* (footnote omitted); see also *Nicks v. Dep’t of Bus. & Prof’l, etc.*, 957 So. 2d 65 (Fla. Dist. Ct. App. 2007).

⁷⁰ 54 C.J.S. *Limitations of Actions* § 134.

⁷¹ *Id.*

⁷² 544 U.S. 408 (2005).

concluded that “[g]enerally, a litigant seeking equitable tolling bears the burden of establishing two elements: (1) that he has been pursuing his rights diligently, and (2) that some extraordinary circumstance stood in his way.”⁷³ In instances of fraudulent concealment of facts, equitable tolling “ceases when those facts are, or should have been, discovered by the plaintiff.”⁷⁴

2. Equitable Tolling and Equitable Estoppel

The main difference between equitable tolling and equitable estoppel lies in the fact that the tolling doctrine does not require any fault or wrongful conduct by the defendant.⁷⁵ Although it is often the case that a plaintiff does not discover the facts for a cause of action because of some sort of fraudulent misconduct on the part of the defendant, the tolling doctrine applies equally for other reasons unrelated to the defendant’s conduct.⁷⁶ On the other hand, equitable estoppel is “intended to prevent a party from taking unconscionable advantage of its own wrong.”⁷⁷ The equitable estoppel doctrine “always presupposes error on one side and fault or fraud upon the

⁷³ *Id.* at 418.

⁷⁴ *Credit Suisse Sec. (USA) LLC v. Simmonds*, 132 S. Ct. 1414, 1420 (2012) (citing 2 CALVIN W. CORMAN, *LIMITATION OF ACTIONS* § 9.7.1, at 55–57 (1991)).

⁷⁵ 54 C.J.S. *Limitations of Actions* § 134.

⁷⁶ 51 AM. JUR. 2D *Limitations of Actions* § 154 (2011). For example, the doctrine

[P]ermits a court to excuse a plaintiff’s failure to comply with a statute of limitations where because of disability, irremediable lack of information, or other circumstances beyond his or her control, the plaintiff cannot reasonably be expected to file suit on time. Accordingly, ignorance of a statutory deadline based on lack of notice or inadequate notice may provide a proper basis for equitable tolling.

Id. (footnotes omitted).

⁷⁷ 28 AM. JUR. 2D *Estoppel and Waiver* § 29.

other and some defect of which it would be inequitable for the party against whom the doctrine is asserted to take advantage.”⁷⁸

3. Statute of Limitations and Statute of Repose

The *Corpus Juris Secundum* differentiates the statute of limitations from the statute of repose in the following simple distinction: “A statute of limitations governs the time within which an action must be commenced after the cause of action accrues. A statute of repose, however, limits the time within which an action may be brought and is not related to the accrual of any cause of action”⁷⁹ Although they are similar concepts in affording the defendant some respite from having an action brought against him or her after a prescribed time period, the difference in determination of when the clock should start to tick provides a very stark contrast—“Unlike an ordinary statute of limitations, which begins running upon accrual of the claim, the period specified in a statute of repose begins when a specific event occurs, regardless of whether a cause of action has accrued or whether any injury has resulted.”⁸⁰ Thus, for a statute of repose, the “injury need not have occurred, much less have been discovered.”⁸¹

Simply put, a statute of limitations bars a plaintiff from bringing a claim if it is not brought *within* a prescribed time period, whereas a statute of repose bars a claim if it is not brought *after* a prescribed time period—the former is a conditional statute while the latter is an absolute statute.⁸² Therefore, it is crucial to determine whether the prescribed period of time in a statute is intended to be one or the other for equitable tolling purposes. A finding of repose will completely bar a potential plaintiff from bringing a stale or

⁷⁸ *Id.* § 28 (footnote omitted).

⁷⁹ 54 C.J.S. *Limitations of Actions* § 7 (2010) (footnote omitted).

⁸⁰ *Id.* (footnote omitted).

⁸¹ *Id.* (footnote omitted).

⁸² *Id.*

outdated claim, no matter how unfair it may be for the diligent plaintiff.⁸³

4. Application to Statutes and Legislative Intent

Generally, it has been stated that application of equitable tolling to a statute depends on underlying policies:

[E]quitable tolling of a statute of limitations is appropriate when consistent with the policies underlying the statute and the purposes underlying the statute of limitations, and equitable tolling is not permissible if it is inconsistent with the text of the relevant statute. Even in the absence of an explicit prohibition on equitable tolling of the statute of limitations, a court may conclude that either the text of the statute or a manifest legislative policy underlying it cannot be reconciled with permitting equitable tolling.⁸⁴

In *Rotella v. Wood*, the Supreme Court stated, “federal statutes of limitations are generally subject to equitable principles of tolling.”⁸⁵ In a subsequent case, the Court explained, “Congress must be presumed to draft limitations periods in light of this background principle” of equitable tolling, especially when it is enacting limitations to be applied by bankruptcy courts, which are courts of equity that apply the principles and rules of equity jurisprudence.⁸⁶ Factors for assessing whether a certain statute of limitations has assumed the presumption of equitable tolling include, but are not limited to: “(1) the statute’s detail, (2) its technical language, (3) its

⁸³ *Id.*

⁸⁴ 51 AM. JUR. 2D *Limitation of Actions* § 153 (2011) (footnotes omitted).

⁸⁵ 528 U.S. 549, 560 (2000); *see also* 54 C.J.S. *Limitations of Actions* § 134.

⁸⁶ *Young v. United States*, 535 U.S. 43, 49–50 (2002); *see also* 54 C.J.S. *Limitations of Actions* § 134.

multiple iterations of the limitations period in procedural and substantive form, (4) its explicit inclusion of exceptions, and (5) its underlying subject matter.”⁸⁷ And so, although federal statutes of limitations are presumed to apply equitable tolling, each statute should be carefully reviewed to determine whether Congress wished to exclude the statute from this general principle.

For claims regarding the federal securities laws, the statute of limitations begins to run from the offer, sale, or delivery by the defendant, whichever occurred last.⁸⁸ Although Congress has clearly expressed its intent in other areas of securities law,⁸⁹ it has unfortunately remained silent as to section 16(b)’s statute of limitations and tolling—“No congressional debate exists on the statute of limitations provision since it was inserted in the conference report.”⁹⁰

*D. Historical Application of Equitable Tolling to Section 16(b)
Claims in the Federal Courts*

This section will first address the methods of equitable tolling applied by different Circuit Courts regarding section 16(b) litigation—notably, the Ninth and Second Circuits. Then the section will discuss the Supreme Court’s application of equitable tolling principles to other areas of federal law before moving to a discussion of the facts and holdings of *Simmonds* in Part III.⁹¹

⁸⁷ 54 C.J.S. *Limitations of Actions* § 134 (footnote omitted).

⁸⁸ 54 C.J.S. *Limitations of Actions* § 287; *see also* *Doran v. Petroleum Mgmt. Corp.*, 576 F.2d 91, 93 (5th Cir. 1978) (“The relevant inquiry was which of the defendant’s activities—offer, sale, or delivery—occurred last as that was the time from which to measure the limitation period.”).

⁸⁹ *See infra* Part V.C for a discussion of the Court’s interpretation of the Rule 10b-5 anti-fraud statute and Congress’s subsequent enactment of the Sarbanes-Oxley Act, which manifested legislative intent as to the statute of limitations/repose for Rule 10b-5.

⁹⁰ 1 ARNOLD S. JACOBS, SECTION 16 OF THE SECURITIES EXCHANGE ACT § 3:52 (2011) (footnote omitted).

⁹¹ The Supreme Court has addressed other issues regarding section 16(b), but it did not address the issue of equitable tolling for this provision until 2012 in

1. Lower Court Three-Way Split

Traditionally, three schools of thought have been established regarding the equitable tolling doctrine's application to section 16(b) claims:

(1) the two-year period runs strictly from the time the profits were realized, without any tolling; (2) the two-year period is tolled until the corporation ha[s] sufficient information to put it on notice of its potential section 16(b) claim; and (3) the "disclosure rationale," namely, that the two-year period is tolled until the insider discloses the transactions at issue by filing the required section 16(a) reports.⁹²

In *Chambliss v. Coca-Cola Bottling Corp.*, the plaintiff shareholders brought a claim under the 1933 Act and the 1934 Act.⁹³ Among other things, the plaintiff brought claim under

78p because the transaction . . . was effectively a 'buying' by the Class 'B' stockholders (and specifically by defendant Mashburn, an owner of more than 10 percentum The transaction was not reported to the Securities Exchange Commission, and the profit realized by the buyers has not been reported to such Commission.⁹⁴

However, the statute of limitations for the Securities Acts ranges from one to three years.⁹⁵ Thus, the 6th Circuit affirmed the

Simmonds. See *Gollust v. Mendell*, 501 U.S. 115, 123–24 (1991) (analyzing the terms "security," "issuer," and "instituted" within the provision).

⁹² Steinberg & Landsdale, *supra* note 45, at 55 (footnotes omitted).

⁹³ 414 F.2d 256 (6th Cir. 1969), *aff'g* 274 F. Supp. 401 (E.D. Tenn. 1967).

⁹⁴ *Chambliss*, 274 F. Supp. at 407 (quotation marks omitted).

⁹⁵ See *infra* note 195.

District Court for the Eastern District of Tennessee's ruling⁹⁶ that the "limitation periods provided in the federal securities acts cited herein are not tolled, for the purpose of an action filed at least fifteen months and as much as thirty-nine months after the expiration of such limitations periods, by the commencement of a prior action within such limitations periods"⁹⁷

a. *Ninth and Second Circuit Courts' Decisions on Section 16(b) Equitable Tolling*

Out of the thirteen circuit courts to have considered these issues, the Second and Ninth Circuit generally carry more supportive authority than the other circuits.⁹⁸ An excerpt from The Leadership Conference on Civil and Human Rights' website nicely summarizes the Ninth Circuit's influence:

The Ninth Circuit is comprised of nine states—California, Nevada, Oregon, Washington, Idaho, Arizona, Montana, Alaska, and Hawaii. Fifty-

⁹⁶ *Chambliss*, 414 F.2d at 257.

⁹⁷ *Chambliss*, 274 F. Supp. at 411.

⁹⁸ See *infra* notes 99–100 and accompanying text. This is true, aside from the D.C. Circuit. Although all Court of Appeals are on the same "level," some are considered more influential than others:

The D.C. Circuit Court is generally considered the second most powerful court (behind only the U.S. Supreme Court) in the nation. The D.C. Circuit Court plays a critical role in national security matters, has considerable regulatory review authority, and is frequently a springboard for judges that are later nominated to the Supreme Court.

Nathanael Bennet, *Senate to Consider Controversial Judicial Nominee While No One is Watching*, ACLJ (Dec. 5, 2011, 10:47 AM), <http://aclj.org/us-constitution/senate-consider-controversial-judicial-nominee-no-one-watching>. Indeed, four of the current Justices of the Supreme Court hail from the D.C. Circuit—Justices Scalia, Thomas, Ginsburg, and Chief Justice Roberts. See Carl Tobias, *Now Hiring: A Few Good Judges*, THE AMERICAN PROSPECT (Feb. 15, 2013), <http://prospect.org/article/now-hiring-few-good-judges>.

four million Americans live in the states within the Ninth Circuit's jurisdiction—more than any other circuit. This means that one in six Americans is potentially affected by the court's rulings.⁹⁹

The Second Circuit includes New York, where many financial institutions are headquartered, thus making it *the* authority when it comes to securities law.¹⁰⁰ For the foregoing reasons (as well as the fact that the present case was appealed from the Ninth Circuit), it would be wise to discuss these courts' application standards.

In contrast to *Chambliss*, the Ninth Circuit and Second Circuit have applied tolling to section 16(b) claims—but with a variation on the established methods of traditional equitable tolling.¹⁰¹ In *Whittaker v. Whittaker Corp.*, the Court of Appeal for the Ninth Circuit held that a section 16(b) statute of limitations is “tolled until the insider discloses the transactions at issue in his mandatory section 16(a) reports,” *regardless* of whether the plaintiff knew or should have known of the conduct at issue.¹⁰² The Supreme Court commented on the difference between this Ninth Circuit ruling, commonly called the “*Whittaker* rule,” and conventional equitable

⁹⁹ *The Crucial Importance of the Ninth Circuit*, THE LEADERSHIP CONFERENCE ON CIVIL AND HUMAN RIGHTS (Apr. 14, 2003), <http://www.civilrights.org/judiciary/courts/ninth-circuit.html>.

¹⁰⁰ See Roberta S. Karmel, *The Second Circuit's Role in Expanding the SEC's Jurisdiction Abroad*, 65 ST. JOHN'S L. REV. 743, 743 (1991). The article states:

The Second Circuit has had such a profound impact on securities law that it has been referred to in this context as the “Mother Court.” The breadth and significance of Second Circuit securities law decisions is not surprising. New York City is the financial center of both the United States and the securities industry, and its legal advisors are located there.

Id. (footnote omitted).

¹⁰¹ See *supra* notes 93–97 and accompanying text.

¹⁰² 639 F.2d 516, 527 (9th Cir. 1981), *abrogated by* *Credit Suisse Sec. (USA) LLC v. Simmonds*, 132 S. Ct. 1414 (2012).

tolling by stating that “some federal courts have used [the] term [‘legal tolling’] to describe [the *Whittaker* rule] on the ground that the rule ‘is derived from a statutory source,’ whereas equitable tolling is ‘judicially created.’”¹⁰³

In *Litzler v. CC Investments, L.D.C.*, the Court of Appeals for the Second Circuit stated, “We now hold that tolling of the limitations period in Section 16(b), . . . using the relevant grace periods of Section 16(a)(2) . . . is appropriate when a defendant has failed to comply with the reporting requirements of Section 16(a).”¹⁰⁴ The Second Circuit further stated that, “tolling should continue only until the claimant or . . . the company gets *actual* notice that a person subject to Section 16(a) has realized specific short-swing profits that are worth pursuing.”¹⁰⁵

b. Delaware’s Treatment of Equitable Tolling

Delaware is a particularly important state when it comes to the law regarding corporations, business transactions, and securities—Delaware has a separate Court of Chancery that “deals largely with corporate issues, trusts, estates, other fiduciary matters, disputes involving the purchase of land and questions of title to real estate as well as commercial and contractual matters.”¹⁰⁶ Delaware became the favored state of incorporation largely due to its “hospitable climate for corporations.”¹⁰⁷ Because of Delaware’s

¹⁰³ *Simmonds*, 132 S. Ct. 1414, 1419 n.6 (quoting *Arivella v. Lucent Techs., Inc.*, 623 F. Supp. 2d 164, 176 (D. Mass. 2009)).

¹⁰⁴ 362 F.3d 203, 207 (2d Cir. 2004), *abrogated by Simmonds*, 132 S. Ct. 1414 (2012) (citations omitted).

¹⁰⁵ *Litzler*, 362 F.3d at 208 (emphasis added) (footnote omitted).

¹⁰⁶ *Overview, DELAWARE STATE COURTS*, <http://courts.delaware.gov/overview.stm> (last visited Oct. 23, 2013).

¹⁰⁷ HAMILTON, MACEY & MOLL, *supra* note 22, at 141. The book quotes former Chief Justice Veasey of the Delaware Supreme Court in describing Delaware’s current status in the corporate area:

Delaware has attracted over 300,000 corporations, including more than half of the Fortune 500 and half of the New York Stock Exchange corporations. It has also attracted some of the

influence in business law applications, it would be informative to peer into the state's decisions regarding tolling of the statute of limitations.

For a plaintiff to toll a statute of limitations in Delaware, regardless of the theory on which the justification is based, "[the] plaintiff bears the burden of showing that the statute was tolled," and "no theory will toll the statute beyond the point where the plaintiff was objectively aware, or should have been aware, of facts giving rise to the wrong."¹⁰⁸ Thus, by adding the "should have been aware" standard, Delaware follows established principles of equitable tolling.¹⁰⁹

2. The Supreme Court's Past Application of Equitable Tolling

In *Burnett v. New York Central Railway Co.*,¹¹⁰ the Supreme Court stated that

[t]he basic question to be answered in determining whether, under a given set of facts, a statute of limitations is to be tolled, is one "of legislative intent whether the right shall be enforceable . . . after the prescribed time." . . . [T]he basic inquiry is whether congressional purpose is effectuated by

finest lawyers in America to our Bar. The role of the Judiciary complements the outstanding work of the Bar, the General Assembly and the Secretary of State's office.

Id. at 143 (quoting E. Norman Veasey, *The Drama of Judicial Branch Change in this Century*, 17 DEL. LAW., Winter 1999/2000, at 4, 4, available at http://delawarebarfoundation.org/delawyer/Volume17_Number4_Winter1999-2000.pdf).

¹⁰⁸ *In re Tyson Foods, Inc. Consol. S'holder Litig.*, 919 A.2d 563, 585 (Del. Ch. 2007) (footnote omitted).

¹⁰⁹ See *supra* Part II.C.

¹¹⁰ 380 U.S. 424 (1965).

tolling the statute of limitations in given circumstances.¹¹¹

In *Lampf*, a group of investors filed complaints against a law firm under section 10(b) of the 1934 Act and SEC Rule 10b-5.¹¹² The plaintiffs claimed that regardless of whether state or federal limitation applies, “that period must be subject to the doctrine of equitable tolling.”¹¹³ Although this case mainly addressed the issue of whether state or federal periods of limitations apply to a private, implied claim¹¹⁴—with the plaintiffs asserting that state common-law fraud doctrines applied, and defendants arguing that federal-law limitations period applied¹¹⁵—the Court addressed a second issue related to equitable tolling.¹¹⁶ The Court stated that statute of limitations “requirements in law-suits . . . are customarily subject to ‘equitable tolling.’”¹¹⁷ Thus, “in the usual case, ‘where the party injured by the fraud remains in ignorance of it without any fault or want of diligence or care on his part, the bar of the statute does not begin to run until the fraud is discovered.’”¹¹⁸ However, the Court noted that “tolling principles do not apply” where there is a clear

¹¹¹ *Id.* at 426–27 (quoting *Mid State Horticultural Co. v. Penn. R. Co.*, 320 U.S. 356, 360 (1943)) (citations omitted).

¹¹² *Lampf*, Pleva, Lipkind, Prupis & Petigrow, 501 U.S. 350, 352 (1991); *see also* 15 U.S.C. § 78j(b) (2012); 17 C.F.R. § 240.10b-5 (2013).

¹¹³ *Lampf*, 501 U.S. at 363.

¹¹⁴ These provisions also fall under the scope of insider trading rules, and are known as the Anti-Fraud Provisions. *See infra* note 122. At the time of this suit, “the claim asserted [was] one *implied* under a statute that also contains an express cause of action with its own time limitation.” *Lampf*, 501 U.S. at 359 (emphasis added). Thus, the courts treated a private cause of action under Rule 10b-5 as being implied with no express time limitation, giving rise to the debate on the applicable statute of limitations. *Id.* at 353–54.

¹¹⁵ *Id.* at 354.

¹¹⁶ *Id.* at 363.

¹¹⁷ *Id.* (quoting *Irwin v. Dep’t of Veterans Affairs*, 498 U.S. 89, 95 (1990)).

¹¹⁸ *Lampf*, 501 U.S. at 363 (quoting *Bailey v. Glover*, 88 U.S. 342, 348 (1875)).

legislative indication of a “cutoff” limitation in the statute.¹¹⁹ Thus, the Court found that Rule 10b-5 contained express language indicating both a statute of limitation and repose: “The 1-year period, by its terms, begins after discovery of the . . . violation, making tolling unnecessary. The 3-year limit is a period of repose inconsistent with tolling.”¹²⁰ For the Rule 10b-5 claim brought in *Lampf*, the clear legislative intent for a period of repose set the claim apart from the “usual case.”¹²¹

The split decisions of the lower courts regarding section 16(b) and equitable tolling can be attributed to the ambiguity of the period of limitation stated within the rule, which is a marked contrast from the clear language of section 10(b).¹²² Section 10(b) offers two time limitations, thus making it clear that one is a statute of limitation, and the other is a statute of repose—an absolute cut-off date. Unlike section 10(b), however, section 16(b) only indicates one period of limitation. Thus, lower court decisions remained split as to whether equitable tolling applied to this period—namely, whether the two-year period was a period of limitation or a period of repose.¹²³

The current case answers the question of whether a claim under section 16(b) can be tolled until formal disclosures of short-

¹¹⁹ *Id.*

¹²⁰ *Id.*; see also 17 C.F.R. § 240.10b-5 (2013).

¹²¹ *Lampf*, 501 U.S. at 363.

¹²² Section 10(b) is the antifraud provision of the 1934 Act. See 15 U.S.C. § 78j(b) (2012). The Sarbanes-Oxley Act, passed in 2002 and expressly supplying intent of Congress regarding section 10(b), provides, in relevant part:

[A] private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws . . . may be brought not later than the earlier of—

(1) 2 years after the discovery of the facts constituting the violation; or

(2) 5 years after such violation.

28 U.S.C. § 1658(b) (2006).

¹²³ See *supra* Part II.D.1.

swing profits have been made pursuant to section 16(a) disclosure requirements.¹²⁴ But it still leaves open the issue of whether equitable tolling applies at all to section 16(b) claims—the Court was divided 4-to-4 on whether section 16(b) “establishes a period of repose that is not subject to tolling.”¹²⁵ Thus, this issue may be decided differently by a majority opinion in the future because this case carries no precedential effect.¹²⁶

The Court has rejected the third school of thought—that the statute of limitations is tolled until a section 16(a) disclosure is made.¹²⁷ But the Court’s language, with the majority opinion written by Justice Scalia—“we conclude that, even assuming that the 2-year period can be extended, the Ninth Circuit erred in determining that it is tolled until the filing of a § 16(a) statement”—gives no concrete conclusion about the application of equitable tolling.¹²⁸ However, Justice Scalia’s majority opinion focuses heavily on traditional equitable tolling principles.¹²⁹

Because of the even 4–4 split regarding whether the statutory period is one of limitation or of repose, the *Simmonds* decision has now brought the lower court split down to two schools of thought.¹³⁰ However, although the opinion explicitly stated that there is no precedential effect, the Supreme Court, in affirming the Ninth Circuit’s application of equitable tolling, may have influenced the circuit courts to lean towards applying equitable tolling principles rather than going the other way.¹³¹ The next two Parts of this note

¹²⁴ See *infra* Part IV for a detailed discussion of the Court’s opinion regarding this issue.

¹²⁵ *Credit Suisse Sec. (USA) LLC v. Simmonds*, 132 S. Ct. 1414, 1421 (2012).

¹²⁶ *Id.*

¹²⁷ See *id.* at 1419; see also *infra* Part IV. The Court unanimously agreed on this holding with an 8–0 decision (Chief Justice Roberts did not participate).

¹²⁸ See *Simmonds*, 132 S. Ct. at 1419.

¹²⁹ See *infra* Part IV.

¹³⁰ *Simmonds*, 132 S. Ct. at 1421.

¹³¹ *Id.*

will relay the facts of *Simmonds* and analyze the Supreme Court's decision and findings.¹³²

III. FACTS

A. *Factual Allegations*

This case originated in 2007 when respondent Vanessa Simmonds filed fifty-five section 16(b) claims against several financial institutions, including Credit Suisse Securities (USA) LLC, which had acted as underwriters for initial public offerings (IPOs) of various companies.¹³³ The “alleged factual basis for each of [the] complaints [was] that the Underwriter Defendants colluded with insiders of the [issuers] and certain investors in order to personally profit from underpriced IPOs.”¹³⁴

Simmonds alleged that the following set of facts supported liability of the underwriters under section 16(b): (1) the underwriters were “statutory insiders” as beneficial owners of more than ten percent of the issuing companies’ stock; (2) the purchase and sale of shares took place in the “immediate aftermarket” of the IPO, thus not meeting the six-month limit; (3) there was a “large discrepancy between the amount . . . paid for the IPO stock and the amount . . . sold . . . in the immediate aftermarket”; and (4) the underwriters “had a pecuniary interest in these transactions because they ‘shar[ed] in the profits of the customers to whom they made IPO allocations of [issuer] stock’” and because they “allocated ‘shares of [issuer] stock to executives and . . . insiders of other companies . . . from which [they] expected to receive new or additional investment banking business in return.’”¹³⁵

¹³² See *infra* Parts III, IV.

¹³³ *Simmonds*, 132 S. Ct. at 1418 (citations omitted).

¹³⁴ *In re* Section 16(b) Litigation, 602 F. Supp. 2d 1202, 1206 (W.D. Wash. 2009).

¹³⁵ *Id.* at 1207 (alteration in original). Simmonds’s claim that the underwriters owned more than ten percent of stock was based on the logic that “as

The underlying actions of the claims took place in the 1990s and 2000, but the lawsuit was not brought until 2007.¹³⁶ Section 16(b) claims are restricted by a statute of limitations of two years.¹³⁷ Although Simmonds's claims were made long after the alleged actions took place, "Simmonds alleged that the underwriters failed to comply with [the] requirement [of section 16(a)], thereby tolling [section] 16(b)'s 2-year time period."¹³⁸

B. Defenses Raised to the Allegations

In their brief to the Supreme Court, the petitioners asserted that Simmonds could not bring her suit for two reasons. First, Simmonds's actions were not timely, since section 16(b) promulgates a two-year repose period that is not to be extended.¹³⁹ Second, even if the period could have been extended, the underwriter exemption applied, resulting in no requirement for the underwriters to have filed a section 16(a) disclosure.¹⁴⁰

The petitioners asserted that the language of section 16(b) established precisely when the statute of limitations should have started to run:

Section 16(b) by its plain terms *specifies* when the two-year time limit begins to run: on "the date such [short-swing] profit was realized." By selecting the

a group, the underwriters and the insiders owned in excess of 10% of the outstanding stock during the relevant time period." *Simmonds*, 132 S. Ct. at 1418.

¹³⁶ *Simmonds*, 132 S. Ct. at 1418.

¹³⁷ See 15 U.S.C. § 78p(b) (2012).

¹³⁸ *Simmonds*, 132 S. Ct. at 1418 (footnote omitted). Section 16(a) of the 1934 Act requires insiders to disclose change in ownership interests. 15 U.S.C. § 78p(a).

¹³⁹ Brief for Petitioners at v, *Simmonds*, 132 S. Ct. 1414 (No. 10-1261) 2011 WL 3678807, at *v.

¹⁴⁰ *Id.* (No. 10-1261) at *35–*36. The Court declined to address the underwriter exemption, and "express[ed] no view on this issue." *Simmonds*, 132 S. Ct. at 1418 n.4. Both the district court and the court of appeals also declined to address the issue. See *Simmonds v. Credit Suisse Sec. (USA) LLC*, 638 F.3d 1072, 1086, 1096 (9th Cir. 2010).

date the defendant engaged in challenged conduct, rather than the date the plaintiff discovered such conduct, as the trigger for the statutory time limit, Congress indicated that such discovery should not extend that limit.¹⁴¹

The petitioners supported their interpretation of congressional intent with other provisions of the Act and prior Supreme Court findings:

Congress confirmed the point in companion provisions . . . which look to a plaintiff's discovery of the facts underlying a claim to *shorten*, not *lengthen*, statutory time limits. Indeed, by reference to these companion provisions, this Court already has characterized section 16(b)'s time limit as a "period of repose" that cannot be extended.¹⁴²

The petitioners pled for reversal of the Ninth Circuit's decision even if the Court were to find an extension of the two-year limit:

Under no circumstances is there any basis for extending that time limit beyond the point at which a reasonably diligent securities owner knew, or should have known, the facts underlying a Section 16(b) action. . . . Accordingly, regardless of whether this Court adopts either a "repose" approach or a "notice"

¹⁴¹ Brief for Petitioners, *Simmonds*, 132 S. Ct. 1414 (2012) (No. 10-1261) at *2 (alteration in original) (emphasis in original) (citation omitted).

¹⁴² *Id.* (emphasis in original) (quoting in part *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 360 n.5 (1991)). In *Lampf*, the Supreme Court found that Rule 10b's anti-fraud provision contained a statute of repose. 501 U.S. at 363.

approach,¹⁴³ this Court should reverse the Ninth Circuit's judgment.¹⁴⁴

The petitioners in *Simmonds* also raised defenses against Simmonds's allegations of underwriter liability: "[T]he SEC has carved out an 'underwriter exemption' to allow underwriters to keep profits from short-swing transactions in the context of public offerings of securities, even if Section 16(b) would otherwise cover the underwriting activity."¹⁴⁵ Simmonds had claimed that the underwriters in the present suit worked with insiders of the issuing company and investors in order to gain personal profits from the IPO.¹⁴⁶ The petitioners acknowledged that the underwriter exemption applied only for "good faith" actions.¹⁴⁷ They offered their definition of "good faith" and alleged that Simmonds's allegations did not meet this definition.¹⁴⁸

Although the most natural reading of that term is that the underwriter exemption applies to all *bona fide* distributions of shares to the public, respondent [Simmonds] advanced a far more expansive view of the "good faith" exception to the underwriter exemption. Thus, respondent attempted to "plead around" the underwriter exemption by alleging that petitioners "lacked good faith in connection with

¹⁴³ See *Litzler v. CC Invs., L.D.C.*, 362 F.3d 203, 206–07 (2d Cir. 2004), *abrogated by* *Credit Suisse Sec. (USA) LLC v. Simmonds*, 132 S. Ct. 1414 (2012) (adopting a version of the notice approach in its equitable tolling application).

¹⁴⁴ Brief for Petitioners, *Simmonds*, 132 S. Ct. 1414 (No. 10-1261) at *3.

¹⁴⁵ *Id.* (No. 10-1261) at *6.

¹⁴⁶ *Id.* (No. 10-1261) at *8; *see also supra* note 135 and accompanying text.

¹⁴⁷ *Id.* (No. 10-1261) at *36 ("To be sure, that exemption applies only to 'good faith' underwriting."); *see also* 17 C.F.R. § 240.16a-7(a) (2013).

¹⁴⁸ The SEC has not offered any authoritative interpretation of the term "good faith" as used in this context. Brief for Petitioners, *Simmonds*, 132 S. Ct. 1414 (No. 10-1261) at *36 (explaining that good faith is a "term that the SEC has never authoritatively construed").

their IPO underwriting and distribution activities” at issue in each lawsuit because of the underlying misconduct alleged.¹⁴⁹

Thus, the petitioning underwriters asserted that (1) the statutory time limit for section 16(b) is a period of repose, rather than a limitation that can be tolled, and that (2) the underwriter exemption applied, thus making it impossible for the Ninth Circuit’s standard to be utilized, as that standard relied on section 16(a) disclosures that the underwriters were not required to make.

C. Lower Court Proceedings

1. Trial Court

Simmonds’s fifty-five claims were “consolidated for pretrial purposes.”¹⁵⁰ The United States District Court for the Western District of Washington dismissed all complaints—twenty-four of the motions to dismiss were granted based on the fact that section 16(b)’s two-year statute of limitations “had expired long before Simmonds filed the suits.”¹⁵¹ Thus, the district court did not address the defendant underwriters’ claim that they were exempt under the underwriter exemption.¹⁵² The plaintiff-respondent appealed the decision, and the Ninth Circuit decided the case in 2010.

¹⁴⁹ Brief for Petitioners, *Simmonds*, 132 S. Ct. 1414 (No. 10-1261) at *36 (emphasis in original) (citation omitted).

¹⁵⁰ *Credit Suisse Sec. (USA) LLC v. Simmonds*, 132 S. Ct. 1414, 1418 (2012).

¹⁵¹ *Id.*

¹⁵² *Simmonds v. Credit Suisse Sec. (USA) LLC*, 638 F.3d 1072, 1086 (9th Cir. 2010).

2. Court of Appeals for the Ninth Circuit

Based on the precedent set in *Whittaker v. Whittaker Corp.*,¹⁵³ the Court of Appeals for the Ninth Circuit reversed the decision in part.¹⁵⁴ Particularly, the Ninth Circuit reversed “the district court’s conclusion that all of Simmonds’s claims are time-barred.”¹⁵⁵ In *Whittaker*, the Ninth Circuit held that section 16(b)’s statute of limitations period is “tolled until the insider discloses his transactions in a Section 16(a) filing, regardless of whether the plaintiff knew or should have known of the conduct at issue.”¹⁵⁶ The petitioner underwriters cited *Lampf*,¹⁵⁷ to argue that “[section] 16(b)’s limitations period is a period of repose, which is not to be ‘extended to account for a plaintiff’s discovery of the facts underlying a claim.’”¹⁵⁸

The Supreme Court of the United States granted certiorari in 2011 to review the issue of “whether the 2-year period to file suit against a corporate insider under § 16(b) of the Securities Exchange Act of 1934 . . . begins to run only upon the insider’s filing of the disclosure statement required by § 16(a) of the Act.”¹⁵⁹ At the time of the Supreme Court’s review, the persons who allegedly violated this rule had yet to file a section 16(a) statement.¹⁶⁰

¹⁵³ 639 F.2d 516 (1981).

¹⁵⁴ *Simmonds*, 132 S. Ct. at 1418.

¹⁵⁵ *Simmonds*, 638 F.3d at 1099.

¹⁵⁶ *Simmonds*, 132 S. Ct. at 1418 (citation omitted).

¹⁵⁷ *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 360 (1991).

¹⁵⁸ *Simmonds*, 132 S. Ct. at 1419 (citation omitted).

¹⁵⁹ *Id.* at 1417 (citations omitted).

¹⁶⁰ *Id.* at 1420.

IV. ANALYSIS OF OPINION

In the present case, the statute of limitations at issue concerns section 16(b) of the Securities Exchange Act of 1934.¹⁶¹

Justice Scalia wrote the majority opinion in *Simmonds*, consisting of one split decision and one unanimous holding. The Supreme Court was “split 4–4 on the question of whether equitable tolling even applies to the two-year period for bringing claims under § 16(b)” and “effectively left that issue open for another day.”¹⁶² But the Court did come to a unanimous holding that “assuming the two-year period can be extended, the tolling rules . . . [of] the Ninth Circuit and Second Circuit impermissibly deviated from ordinary equitable tolling principles.”¹⁶³

A. *The Supreme Court’s Rejection of the Ninth Circuit’s Whittaker Rule to Section 16(b) Claims*

The Supreme Court rejected *Simmonds*’s argument that the *Whittaker* rule applied, basing its rejection on two main rationales.¹⁶⁴ First, under what seems to be a congressional intent analysis, the Court stated that the text of section 16 “simply does not support the *Whittaker* rule” because the statute expressly stated that the “2-year clock starts from ‘the date such profit was realized.’”¹⁶⁵ The Court noted that “Congress could have very easily provided that ‘no such suit shall be brought more than two years after *the filing of a statement under subsection (a)(2)(C).*’”¹⁶⁶

¹⁶¹ See *supra* Part II.A for a detailed discussion of the rule; see also *supra* Part II.C for a discussion of the split of authority for this issue before the *Simmonds* decision.

¹⁶² *Supreme Court Rejects Open-Ended Tolling Of Section 16(b) Claims In Simmonds*, 9 NO. 5 SEC. LITIG. REP. 18 (2012) [hereinafter *Supreme Court Rejects Open-Ended Tolling*].

¹⁶³ *Id.*

¹⁶⁴ *Simmonds*, 132 S. Ct. at 1419–20.

¹⁶⁵ *Id.* at 1419 (citation omitted).

¹⁶⁶ *Id.* (emphasis in original).

Second, the Supreme Court noted that the purpose of the *Whittaker* rule is “inconsistent with the general purpose of statutes of limitations,” and that the rule does not coincide with established principles of equitable tolling.¹⁶⁷ The Court lends a reminder that the purpose of a statute of limitations is “to protect defendants against stale or unduly delayed claims.”¹⁶⁸ In addressing equitable tolling, the Court stated that “[t]he *Whittaker* court suggested that the background rule of equitable tolling for fraudulent concealment operates to toll the limitations period until the § 16(a) statement is filed.”¹⁶⁹ The Court opined that the *Whittaker* rationale would actually be “inequitable” tolling, which is especially apparent in the present case.¹⁷⁰ It explained that the *Whittaker* rule’s inequitable application was exemplified by the fact that the liability theory regarding underwriters was “so novel that . . . [underwriters] can plausibly claim that they were not aware they were required to file a § 16(a) statement. And where they disclaim the necessity of filing, the *Whittaker* rule compels them either to file or to face the prospect of § 16(b) litigation in perpetuity.”¹⁷¹ The Court pointed out the anomaly that Simmonds’s argument would create, because she knew about the purchase and sale, and had sued, but the underwriters had not yet filed a section 16(a) disclosure; thus, she still had two years to sue continually until they file.¹⁷² Even Simmonds acknowledged the possibility of this inequity.¹⁷³

The Supreme Court ultimately relied on a congressional intent analysis in reaching its decision to “reject [such] a departure from

¹⁶⁷ *Id.*

¹⁶⁸ *Id.* at 1420 (citation omitted).

¹⁶⁹ *Id.* at 1419 (footnote omitted). “Generally, a litigant seeking equitable tolling bears the burden of establishing . . . (1) *that he has been pursuing his rights diligently*, and (2) that some extraordinary circumstance stood in his way.” *Id.* (emphasis in original) (citing *Pace v. DiGuglielmo*, 544 U.S. 408, 418 (2005)). See *supra*, Part II.C–D for a detailed discussion on equitable tolling.

¹⁷⁰ *Simmonds*, 132 S. Ct. at 1420.

¹⁷¹ *Id.*

¹⁷² *Id.*

¹⁷³ *Id.*

settled equitable-tolling principles.”¹⁷⁴ The Court determined, based on the express words of section 16(b), that the statute of limitations runs from when profit is realized, stating that “Congress did not intend that the limitations period be categorically tolled until the statement is filed: The limitation provision does not say so.”¹⁷⁵ The Court further explained that “[t]he usual equitable-tolling inquiry” is sufficient because “the limitations period would not expire until two years after a reasonably diligent plaintiff would have learned the facts underlying a § 16(b) action.”¹⁷⁶ The Court supported its ruling regarding the sufficiency of the usual equitable tolling principles by explaining that when courts apply a doctrine or principle to an issue that Congress is silent about, they may “permit[] an inference that Congress intended to apply *ordinary* background . . . principles,” and *not* that Congress “intended to apply an unusual modification of those rules.”¹⁷⁷

B. The Unsettled Issue of Whether the Equitable Tolling Principle Applies to Section 16(b)’s Time Limit

Although the Court held that section 16(b)’s “limitation . . . period is not tolled until” a section 16(a) statement is filed, it expressly stated that “[w]e are divided 4 to 4 concerning, and thus affirm without precedential effect, the Court of Appeals’ rejection of petitioners’ contention that § 16(b) establishes a period of repose that is not subject to tolling.”¹⁷⁸

But in affirming the Ninth Circuit’s application of equitable tolling, although without precedential effect, the Court may have influenced the courts of appeals to apply equitable tolling rather than go the other way. And because of the dearth of section 16(b)

¹⁷⁴ *Id.*

¹⁷⁵ *Id.*

¹⁷⁶ *Id.*

¹⁷⁷ *Id.* at 1421 (emphasis in original) (quoting *Meyer v. Holley*, 537 U.S. 280, 286 (2003)).

¹⁷⁸ *Id.*

litigation in recent years, it may take some time before the issue is brought before a circuit court, especially one that had applied the “repose” school of thought prior to the *Simmonds* decision.¹⁷⁹

V. IMPACT

Because the Supreme Court essentially left the issue of the applicability of ordinary principles of equitable tolling open, it is necessary to peer into the decisions of several courts to find how each court may differently treat a section 16(b) claim—some courts of appeals may not apply equitable tolling at all, and some courts may apply general principles of equitable tolling. Unfortunately, too few cases have been heard on this issue, both before and after *Simmonds*. This section will summarize interpretations that have formed after *Simmonds*, and then refer to impacts resulting from the Supreme Court’s holding on another provision pertaining to insider trading.

A. Interpretations of the *Simmonds* Decision

“Lower courts now will have to decide how traditional principles of equitable tolling apply, and may consider anew whether equitable tolling should even apply to § 16(b).”¹⁸⁰ Thus, this issue will likely go to the Supreme Court again—someday—and at that time, the Court may decide that equitable tolling need not apply at all.¹⁸¹ In the *Securities Litigations Report*, however, the authors viewed the Supreme Court as “favoring strict statutory interpretation to define the scope of the federal securities laws.”¹⁸² It elaborated by explaining that the Court “narrowly construe[s] the private rights of action arising under the federal securities laws to curb the

¹⁷⁹ Most section 16(b) claims have been brought in the Ninth and Second Circuits, and both courts have traditionally applied equitable tolling principles to those causes of action. This fact, coupled with the small number of section 16(b) cases, means the chances of this issue being brought up in a different circuit court in the short to mid term are likely low.

¹⁸⁰ *Supreme Court Rejects Open-Ended Tolling*, *supra* note 162, at 19.

¹⁸¹ *Id.*

¹⁸² *Id.*

development of novel and expansive theories of liability that Congress did not contemplate or expressly authorize.”¹⁸³ After all, section 16(b) clearly states that a cause of action exists for two years after profits are made—which some may interpret as a period of repose. In the future, much of the decision may depend on how easily detectable short-swing profits are in measuring the fairness of applying a short, two-year period of repose.

B. Subsequent Lower Court Decisions

After the reinforcement of other provisions regulating insider trading, “The number of reported § 16(b) cases has declined significantly in the last two decades.”¹⁸⁴ Two likely factors for this decrease are “improved distribution of information about the dangers of inadvertent violations” and “exemptive regulations promulgated by the SEC in 1991 and 1996” regarding section 16(b) liability.¹⁸⁵ Thus, as a result of the recency of the Supreme Court’s decision in *Simmonds*, and the lack of cases arising under section 16(b) in general, very few subsequent cases have come before the federal courts. Thus far, the few subsequent cases involving section 16(b) litigation originate from New York, the financial capital of the world, and only one directly applies the *Simmonds* decision.

In *Chechele v. Morgan Stanley*, the plaintiff, Chechele, sued Morgan Stanley and its subsidiaries, seeking disgorgement of short-swing profits.¹⁸⁶ The District Court for the Southern District of New York, relying on the Supreme Court decision in *Simmonds*, departed from the old Second Circuit precedent, which mandated that tolling end when the plaintiff “gets actual notice that a person subject to

¹⁸³ *Id.* at 20.

¹⁸⁴ HAMILTON, MACEY & MOLL, *supra* note 22, at 929.

¹⁸⁵ *Id.* “The last sentence of § 16(b) grants the SEC power to exempt transactions from that section if they are ‘not comprehended within the purpose of this subsection.’” *Id.*

¹⁸⁶ 896 F. Supp. 2d 297, 297 (S.D.N.Y. 2012).

section 16(a) has realized specific short-swing profits.”¹⁸⁷ With the old Second Circuit rule overturned, *Chechele* followed the Supreme Court’s *Simmonds* holding and applied the Second Circuit’s usual principle for equitable tolling: “we will apply the equitable tolling doctrine ‘as a matter of fairness’ where plaintiff has been ‘prevented in some extraordinary way from exercising his rights.’”¹⁸⁸ The court found that the plaintiff knew or should have known “the facts necessary to plead her section 16(b) claim more than two years” before filing the complaint.¹⁸⁹ It held that she did not (1) “pursu[e] her rights diligently” or (2) show “that some extraordinary circumstance stood in her way.”¹⁹⁰ Because these were two essential elements to toll a statute of limitations for fraud, the court dismissed her action as “time-barred.”¹⁹¹

C. Other Influential Supreme Court Decisions on Statute of Repose for Insider Trading Provisions and Congressional Response

Having only answered one of the issues—regardless of whether equitable tolling applies, the clock does not run after a required disclosure—the Supreme Court has left the question of whether equitable tolling even applies to section 16(b) at all for another day. To address the question of how the Court may decide if this issue were brought up again, it would be helpful to review other Supreme Court decisions regarding related provisions in securities law. The most obvious provision to analyze would be section 10(b) and the accompanying Rule 10b-5’s anti-fraud provisions. It would

¹⁸⁷ *Id.* at 302 (quoting *Litzler v. CC Invs., L.D.C.*, 362 F.3d 203, 208 (2d Cir. 2004), *abrogated by* *Credit Suisse Sec. (USA) LLC v. Simmonds*, 132 S. Ct. 1414 (2012)).

¹⁸⁸ *Chechele*, 896 F. Supp. 2d at 303 (quoting *Miller v. Int’l Tel. & Tel. Corp.*, 755 F.2d 20, 24 (2d Cir. 1985)). The court further emphasized that “we had in mind a situation where a plaintiff ‘could show that it would have been impossible for a reasonably prudent person to learn’ about his or her cause of action.” *Id.* (emphasis in original).

¹⁸⁹ *Chechele*, 896 F. Supp. 2d at 304.

¹⁹⁰ *Id.* (quoting *Pace v. DiGuglielmo*, 125 S. Ct. 1807, 1814 (2005)).

¹⁹¹ *Chechele*, 896 F. Supp. 2d at 304.

also be beneficial to review the legislature's reaction to the Court's Rule 10b-5 limitation period decision in order to better understand Congress's administrative intent.

This section will first discuss how section 10(b) relates to section 16(b) and then analyze the procedural and legislative history of the provision's statutory time limit in order to catch a glimpse of how the Supreme Court and Congress may react to a future claim based on a section 16(b) issue. Finally, this section will detail other comments and opinions to gain insight into the views of some of the Justices.

1. The Supreme Court's Decisions on Section 10(b)'s Period of Limitation

Aside from section 16(b) of the 1934 Act, most insider trading cases arise under Rule 10b-5 claims—section 10(b) and the SEC's accompanying Rule 10b-5 “are the principal statutory weapons against fraud. Section 10b is the antifraud provision of the Exchange Act, while Rule 10b-5 is the rule the SEC promulgated under that section.”¹⁹² Before statutory limitations periods existed, courts generally utilized four different alternatives in applying a statutory limitations period to fraud claims,¹⁹³ with one of the methods borrowing language from section 16(b):

- (1) apply by analogy the statutes of limitations applicable to private remedies under Section 13 of the 1933 Act; (2) apply the forum state's statute of limitations for common law fraud; (3) apply the

¹⁹² Legal Info. Inst., *Securities Exchange Act of 1934*, CORNELL UNIVERSITY LAW SCHOOL, http://www.law.cornell.edu/wex/securities_exchange_act_of_1934 (last visited Oct. 25, 2013). “Rule 10b-5 prohibits the use of any ‘device, scheme, or artifice to defraud,’ and creates liability for any misstatement or omission of a material fact, or one that investors would think was important to their decision to buy or sell the stock.” *Id.*

¹⁹³ HAZEN, *supra* note 39, § 12.16[1].

statute of limitations for securities fraud under the forum state's blue sky law;¹⁹⁴ or (4) apply the limitations period from section 9(e), section 16(b), or section 18(a). . . .¹⁹⁵

Beginning in 1988, Rule 10b-5 authorized private rights of action through express congressional measures.¹⁹⁶ However, Congress remained silent as to the legislative intent regarding the statute of limitations.

Finally, in 1991, the issue of section 10(b) and Rule 10b-5's statute of limitations came before the Supreme Court in *Lampf*.¹⁹⁷ In the *Lampf* decision, the Court held that "[l]itigation instituted pursuant to § 10(b) and Rule 10b-5 . . . must be commenced within one year after the discovery of the facts constituting the violation and within three years after such violation."¹⁹⁸ In effect, the Supreme Court had created a one-year statute of limitations—running from the time of discovery of the violation—and a three-year statute of repose that would not be affected by any tolling doctrines. The Court based its decision on the following rationale:

[A] court should look first to the statute of origin to ascertain the proper limitations period. We can imagine no clearer indication of how Congress would have balanced the policy considerations implicit in

¹⁹⁴ See *supra* Part II.B for a description of state common law fraud time limitations and blue sky laws.

¹⁹⁵ HAZEN, *supra* note 39, § 12.16[1]. The limitation for private remedies deemed the period to be "one year from discovery or reasonable discovery but no more than three years after the sale or, if applicable, from the public offering." *Id.* Section 9(e), now called section 9(f), states the limitation as "one-year from discovery, three years after violation." *Id.* at n.3. Section 18(a) prescribes the period to be "one year from discovery, three years after the violation." See also 15 U.S.C. § 77m (2012).

¹⁹⁶ HAZEN, *supra* note 39, § 12.16; see also 15 U.S.C. § 78t-l.

¹⁹⁷ See *Lampf*, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350 (1991); see also Part II.D.2.

¹⁹⁸ *Lampf*, 501 U.S. at 364; see also 17 C.F.R. § 240.10b-5 (2013), for details on Rule 10b-5.

any limitations provisions than the balance struck by the same Congress in limiting similar and related protections.¹⁹⁹

Following this rationale, the Court relied on other provisions of the 1933 and 1934 Acts.²⁰⁰ The Court commented on the standard of application that a lower court should use in the absence of a finding of a clear legislative intent:

Where a federal cause of action tends in practice to “encompass numerous and diverse topics and subtopics,” such that a single state limitations period may not be consistently applied within a jurisdiction, we have concluded that the federal interests in predictability and judicial economy counsel the adoption of one source, or class of sources, for borrowing purposes.²⁰¹

This statement alludes to a favor of uniformity in application of a statute of limitations and repose to further legitimate federal interests and policy considerations.

¹⁹⁹ *Lampf*, 501 U.S. at 359.

²⁰⁰ DAVID A. LIPTON, 15A BROKER-DEALER REG. § 5:30 (2011-2012). The existing statutes that the Court relied on were as follows: 15 U.S.C. § 78i(e), 15 U.S.C. § 78r(c), and 15 U.S.C. § 77m. *Id.* Also, regarding distinctions in terminology for the different one- and three-year periods within the 1933 and 1934 Acts, the Court noted, “To the extent that these distinctions in the future might prove significant, we select as the governing standard for an action under § 10(b) the language of . . . 15 U.S.C. § 78i(e).” *Lampf*, 501 U.S. at 364 n.9. The majority opinion, written by Justice Blackmun, briefly addressed section 16(b); it had been considered for reliance but ultimately dismissed from consideration because its focus—disgorgement of unlawful profits—differed from section 10(b). *Id.* at 360 n.5. Another possible reason, although not stated in the opinion, could be because section 16(b) did not contain the two-tiered limitation structure that section 10(b) and the others contained.

²⁰¹ *Lampf*, 501 U.S. at 357.

2. Congressional Response to *Lampf*: Affirmed in Part

Congress expressed its agreement with the *Lampf* decision on two occasions following 1991. First, within one year of the Supreme Court's decision, Congress added section 27A to the 1934 Act, which provided that for private civil actions under section 10(b), "the limitations period is that provided by the laws applicable in the jurisdiction as they existed on June 19, 1991."²⁰² Although this addition denied retroactive application of the *Lampf* decision, it also acknowledged the statute of limitation and repose set by the Court's holding for future actions. The second instance occurred in concurrence with efforts to recover from the accounting scandals of 2002.²⁰³ Congress passed a new Act, which provided more concrete recognition of the issues discussed in *Lampf* and the need to expressly state a statute of limitations and repose:

²⁰² LIPTON, *supra* note 200; *see also* 15 U.S.C. § 78aa-1.

²⁰³ "Numerous events involving fraud and misconduct . . . shocked and angered both the business community and ordinary investors. Investors began to bail out of securities holdings, and a sharp decline in securities prices followed." HAMILTON, MACEY & MOLL, *supra* note 22, at 547. Although several corporate wrongdoings define this era, "Undoubtedly, the most violent initial shock . . . was the unexpected collapse of Enron Corporation in November, 2001." *Id.* at 541. Just one year earlier, Enron had been hailed by Fortune magazine as one of the most admired companies. *Id.* at 542; *see also* Nicholas Stein, *The World's Most Admired Companies*, FORTUNE, Oct. 2, 2000, at 182. Enron and thirteen affiliates had filed for bankruptcy as a result of overstating earnings and creating "special purpose entities" to hide "very substantial liabilities and avoid disclosure." HAMILTON, MACEY & MOLL, *supra* note 22, at 542. The once prominent accounting firm Arthur Andersen also collapsed with the scandal, as it had been the auditor for Enron—the firm "had engaged in a 'cleaning' of Enron files related to its financial activities shortly before Enron collapsed, and as a result was convicted of obstruction of justice." *Id.* at 543. Another notable collapse was that of WorldCom, a telecommunications corporation. The company announced in 2002 that it had overstated profits by categorizing certain expenses as capital investments instead. *Id.* at 543–44. Senior executives "were arrested and charged with securities fraud, conspiracy to commit securities fraud and making false statements to the SEC." *Id.* at 544. For a more detailed account of the series of events leading up to the enactment of the Sarbanes-Oxley Act, *see id.* at 540–49.

In July 2002, the Sarbanes-Oxley Act [(SOX)] . . . was signed into law. This Act, approved by nearly unanimous votes in both houses of Congress . . . amended a general statute of limitation which applies to civil actions arising under Acts of Congress. . . . The [SOX] amendment provided that, notwithstanding the general limitations period, a separate statute of limitations will apply to a private action, involving “a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the ‘securities laws.’”²⁰⁴

Congress altered the Supreme Court’s decision in *Lampf* to declare that the statute of limitations is two years and the statute of repose is five years.²⁰⁵

Courts have limited SOX application to Rule 10b-5, based on a distinction found in the texts of the Act’s provisions that read: “The violations to which SOX’s limitations apply sound in fraud. Many of the ‘anti-fraud’ provisions of the securities acts, however, on their face, apply to misstatements which might or might not involve fraud.”²⁰⁶ Most recently, in *Merck & Co. v. Reynolds*, the Supreme Court, for the first time, interpreted the two-year statute of limitations set by SOX.²⁰⁷ The Court held that “a cause of action accrues (1)

²⁰⁴ LIPTON, *supra* note 200 (footnotes omitted); *see also* 28 U.S.C. § 1658(b).

²⁰⁵ 28 U.S.C. § 1658(b). In *Lampf*, the Solicitor General had “appear[ed] on behalf of the [SEC] . . . urg[ing] the application of [a] 5-year statute of repose.” *Lampf*, 501 U.S. at 355. The Court had rejected this for other limitations written in the original Acts. However, Justice Kennedy’s dissent pointed towards no period of repose for fraud-based claims or, as the Solicitor General urged and as Congress later implemented, a reasonable five-year period. *See id.* at 374–79 (Kennedy, J., dissenting); *see also infra* Part VI for a further explanation of his dissent.

²⁰⁶ 28 U.S.C. § 1658(b).

²⁰⁷ 130 S. Ct. 1784 (2010). The case involved a claim brought by a group of investors against Merck for “knowingly misrepresent[ing] the risks of heart

when the plaintiff did in fact discover, or (2) when a reasonably diligent plaintiff would have discovered, ‘the facts constituting the violation’—whichever comes first.”²⁰⁸ The Court deemed, and all parties agreed, that “discovery” referred “not only to a plaintiff’s *actual* discovery of certain facts, but also to the facts that a reasonably diligent plaintiff would have discovered.”²⁰⁹ It further noted that “[f]raud is deemed to be discovered . . . when, in the exercise of reasonable diligence, it could have been discovered.”²¹⁰

VI. CONCLUSION

Although the decision in *Credit Suisse Securities (USA) LLC v. Simmonds* does give guidelines on the limits of equitable tolling for section 16(b) claims, the Supreme Court’s split decision still leaves this issue unresolved.

Justice Blackmun, who wrote for the majority in *Lampf*, expressly stated, “Section 16(b) . . . sets a 2-year rather than a 3-year period of *repose*.”²¹¹ Justice Scalia, in his concurrence, did not raise issue with this statement.²¹² Justice Kennedy wrote a separate dissent in which he generally disagreed with the application of any short period of repose for fraud-based actions, and indicated that only in rare circumstances could a five-year repose period be imposed.²¹³ He had, however, also opined that “[a] reasonable statute of repose . . . is not without its merits. It may sometimes be easier to determine when

attacks accompanying the use of Merck’s pain-killing drug” and brought an action for securities fraud under section 10(b) of the 1934 Act. *Id.* at 1790.

²⁰⁸ *Id.* at 1789–90.

²⁰⁹ *Id.* at 1793 (emphasis in original). The Court commented that the word “discover” in statute of limitations determinations was often connected to the “discovery rule” doctrine, which “delays accrual of a cause of action until the plaintiff has ‘discovered’ it.” *Id.*

²¹⁰ *Id.* at 1794.

²¹¹ *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 360 n.5 (1991) (emphasis added).

²¹² See *id.* at 364–69 (Scalia, J., concurring in part).

²¹³ *Id.* at 377–78 (Kennedy, J., dissenting).

a fraud occurred than when it should have been discovered.”²¹⁴ He thus indicated that in some types of claims, he would not be as closed to the possibility of a statute of repose, so long as it would not upset principles of fairness. In his *Lampf* dissent, Justice Kennedy stated a key point—the limitation statutes that the Majority relied on “appl[ie]d to strict liability violations.”²¹⁵ Section 16(b) is also a form of strict liability. Will the Court turn to its *Lampf* methodology or depart from it? Will it consider the congressional trend toward administering both a statute of limitations *and* a statute of repose?

As for the legislature, through its decisions in adopting SOX and the other regulations preceding it, Congress is moving towards administering a dual time limitation structure of (1) a shorter statute of limitations from time of discovery and (2) a longer statute of repose. And as discussed earlier, Congress has applied shorter statute of repose periods for strict liability type provisions.

The Supreme Court may have fortunately, or conveniently, avoided a final decision involving the sensitive task of interpreting legislative intent, this time, with *Simmonds*. And it may very well have dodged the task of resolving this issue for a substantial time to come, thanks to difficulties explained earlier in this case note—namely, a dearth of section 16(b) litigation. But unless legislation does away with section 16 of the 1934 Act, the Supreme Court will have to address the split of opinion among the courts—and an important factor in its analysis will likely be how readily discoverable section 16 violations are, and the importance of striking a balance of fairness between the claimants and the alleged violators.

²¹⁴ *Id.* at 378.

²¹⁵ *Id.* at 376.